Business Matters

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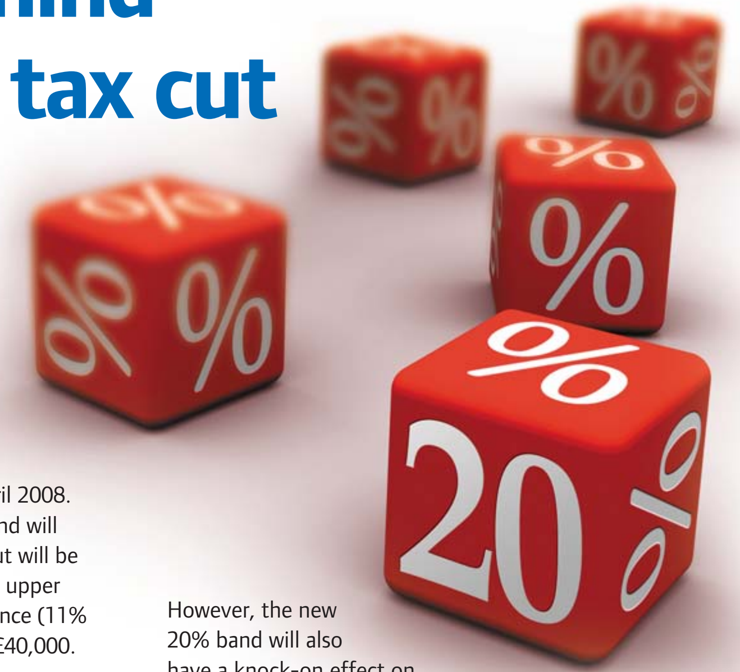
Looking behind the income tax cut



Gordon Brown may have intended his last Budget to be remembered for the dramatic cut in the basic rate of income tax from 22% to 20%, but what does the headline-grabbing measure really mean? Tax increases, which will come into effect at the same time, may mean that many taxpayers will see little benefit from the cut in real terms.

The new 20% tax rate will take effect on 6 April 2008. On the same day, the 10% starting rate tax band will continue to be available for savings income, but will be removed for all other types of income, and the upper income limit for the main rate of national insurance (11% for employees) will increase to approximately £40,000.

As a result of these changes taken together, a single person on a salary of £15,000 will pay about £24 more in tax in 2008/09, but someone currently in the upper tax bracket on a salary of £45,000 will reap a net saving of about £240. This is because the person on the lower salary loses the benefit of the 10% rate, while the higher paid individual benefits from the raising of the threshold at which the 40% tax rate starts. However, this is offset to a considerable extent by the increase in national insurance contributions.

These figures do not take into account any working or child tax credits which the individual may be able to claim. It is very difficult to generalise about the effect that tax credits will have on the average family, as this calculation must take many factors into account.

Winners and losers

If you receive most of your income in the form of rents, you could be one of the winners from the cut in the basic rate of income tax. Rental income does not generally attract national insurance, so the reduction in the income tax rate to 20% will not be cancelled out by the increase in national insurance, as it is for income from a salary.

However, the new 20% band will also have a knock-on effect on personal pension contributions. Currently, if you want to pay £4,000 into your pension fund, you must make a contribution of £3,120 net of 22% tax, and the pension scheme reclaims £880. From 6 April 2008, in order to achieve the same payment into your pension fund you will have to pay £3,200 net of 20% tax, and the pension scheme will reclaim £800. This means that you will end up paying £80 more into your pension scheme for the same result.

Charities will also be affected by the reduction in the basic rate. At present when you make a charitable gift of £100 and certify it under the gift aid scheme, the charity can claim back a further £28.20 from HM Revenue & Customs (HMRC). From 6 April 2008, the same gift of £100 will only be worth £125 to the charity, so they will lose £3.20 of income for every £100 of gift-aided donations.

There will be some clear winners and losers as a result of the new income tax rates, and much will depend on individual circumstances. If you would like to know more about how the new rates could affect you, please contact us for further advice.

Summer 2007

Inside this issue

How well do you know your suppliers and customers?

It is always a good idea to know who you are doing business with, but if you deal in certain electronic goods this may be of particular significance, as HM Revenue & Customs (HMRC) could have the power to demand from you any unpaid VAT arising in the supply chain.

The list of goods concerned currently includes mobile phones and computer equipment, but with effect from 1 May 2007 this list has been expanded to include many commonly sold electronic leisure items, such as satellite navigation systems.

If one of your customers or suppliers (or a supplier further up the chain) fails to pay the VAT on specified goods and you knew or had reasonable grounds to suspect that it would go unpaid, you could be left with part or all of that VAT liability. The only way to avoid this is to show that you have taken reasonable steps to establish the integrity of your supplies, suppliers and customers.

This could involve the following checks:

- Obtain a copy of the company's certificate of incorporation and double check the company number shown with Companies House
- Ask for a copy of the VAT registration certificate and verify the VAT number with HMRC
- Get third party references for all suppliers
- Undertake a credit check for all wholesale customers
- If possible make a personal visit to the trading address given, to see if the business does actually trade from those premises.

HMRC also suggests that businesses should consider carefully any transaction that appears to offer a very good deal, or comes with unusual terms, such as having to pay in cash, or into an offshore bank account.
If you are approached by a business that has little or no history, and appears to offer a guaranteed profit on a deal, it may be wise to remain cautious. Do the goods they are offering actually exist and do they fit the description given? Is the transaction commercially viable? Your own trading reputation and cash security could be at risk if you get caught up in deals that involve VAT fraud.

R&D tax relief: could your business benefit?

One of the more significant announcements arising from the Budget was an extension, from April 2008, of the value of research and development (R&D) tax relief, from 125% to 130% for large companies and from 150% to 175% for smaller companies. That sounds like a tax relief worth having, so how can ordinary businesses benefit?

The R&D tax relief applies when a business undertakes a research project with the aim of developing something totally new (or an appreciable improvement) to science. This might be a new material, a new technology or machine, or perhaps a method of cleaning up pollution.

However, there are some restrictions on the areas of innovation that can qualify for the tax relief scheme. Advances in pure mathematics are not considered to be science for these purposes, so a project to develop new algorithms to manipulate data will not win the extra tax relief. Similarly research in the area of social sciences, such as developing a new marketing tool, will not qualify. Many internet-based innovations may fall into the mathematical or social sciences traps.

How to claim

If you do have a project that may qualify for the relief, you will need to keep track of the following types of expenses that are connected with the project: staff costs, consumable items (including software), and direct energy and water costs. Where these costs amount to at least £10,000 in one year, you could have the basis for an R&D tax relief claim.

While you would get a full deduction for these costs against your profits in any event, the R&D tax relief gives an extra 75% for a small or medium sized business, or an extra 30% for a large business. A large business is defined as having 250 or more employees, although that threshold may be increased to 500 in the future; there is also a turnover/balance sheet test for a large business.

To make the claim for R&D tax relief, you will initially need to complete a few entries on your corporation tax return. The tax office will almost certainly ask for further information to back up your claim, and at that stage you may need to provide a non-technical description of your research project and a full analysis of the costs. This can be quite time consuming, but we can help you with this, and the extra tax relief may well be worth it.

Capital Allowances – the new system

The 2007 Budget introduced some substantial changes to the Capital Allowances system of tax reliefs. As a result, business owners will need a greater awareness of the opportunities available in order to maximise their tax savings under the new regime.

When you buy a piece of equipment to use in your business you cannot normally set the full cost against that year's profits, unless the value of the item is quite small, or a special tax relief applies. The cost of more expensive items is written off against your profits over a number of years, using the Capital Allowances system. The same principle applies for expenditure on certain types of buildings.

Annual Investment allowance (AIA)

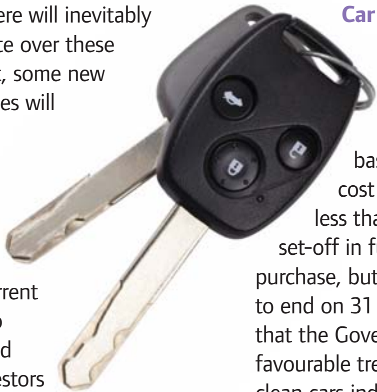
From April 2008 it is proposed that there will be a new investment allowance - the first £50,000 spent on equipment in one year by any business will be set-off in full against the profits for that year. This allowance should cover most items of plant and machinery purchased by smaller businesses. Where the business spends more than £50,000 in one year the excess will be written off against profits at a rate of 20% per year (reducing balance). The current rate is 25%.

Industrial Buildings

The capital allowances currently available for the cost of industrial and agricultural buildings of 4% per year will be reduced to 3% from April 2008, to 2% from April 2009, and then only 1% from April 2010. No allowances will be due for most buildings from April 2011. However, balancing adjustments ceased with effect from 21 March 2007, meaning no repayment on disposals.

Background plant

From April 2008 a new categorisation of some equipment as 'background plant' will be introduced, which will be written down at a rate of 10% per annum. This will apply to all the basic plant in a building – this is yet to be fully defined, but is likely to include such things as heating, hot water and lifts. It will therefore become necessary to separate claims into 'background plant' and 'trade-related plant'. There will inevitably be some scope for debate over these categories and no doubt, some new tax planning opportunities will emerge.



With no changes being made until April 2008, it appears that there will be an opportunity to submit claims on the current single pool basis with no separation of background plant. Businesses or investors who have any current or past expenditure on acquisitions, new build, or refurbishments that has not been analysed might consider taking advantage of this timing window. There is no time limit on making historic claims on property expenditure and bringing these allowances into current tax computations.

2008 and beyond – the Green Agenda

A key effect of the new classifications will be to put greater emphasis on the 'green agenda'. The Enhanced Capital Allowances scheme means that energy-saving or low carbon emission equipment attracts a 100% First Year Allowance. Early consideration in specifying a scheme is necessary, if this is not to be overlooked. Notably in a refurbishment it is not only the qualifying equipment which attracts a 100% relief, but also the associated works such as removal of the previous equipment and 'making good'.

Car emissions

The definition of equipment for the investment allowance will not include cars, as they will attract capital allowances based on their CO_2 emissions. The cost of cars with low emissions of less than 120g/km can currently be set-off in full against profits in the year of purchase, but this special treatment was due to end on 31 March 2008. It is expected that the Government will extend this favourable treatment for these relatively clean cars indefinitely.

It is proposed that the cost of cars with CO_2 emissions between 121g/km and 165g/km will be deductible from profits at the rate of 20% per year. The capital allowances for the most polluting cars with CO_2 emissions of over 165g/km have not been announced, but they may be as low as 10% per year.

With careful planning there are still significant opportunities to save tax. Contact us for more information.

HMRC announces 'tax amnesty' for offshore income

HM Revenue & Customs (HMRC) recently announced the launch of its Offshore Disclosure Facility. The facility is primarily aimed at those individuals with undisclosed offshore income, providing them with the opportunity to disclose any income and gains not previously included in their tax returns.

Under the scheme, investors must notify HMRC of their intention to make a disclosure by 22 June, and payments must be made by 26 November. Investors must pay in full all previously unpaid taxes covering the last 20 years, plus any interest due, and penalties will be capped at 10% of the tax owed. After this time the facility will be withdrawn and the penalties are set to rise.

The move follows previous legal rulings which forced five major High Street banks to divulge details of UK taxpayers with overseas accounts.

You are advised to seek specialist advice if you have any concerns about this issue.

Business Round-up: Smoking in the workplace is outlawed

With effect from 1 July 2007, smoking is banned in all enclosed workplaces and public places in England, with a limited number of exceptions. The new rules follow the introduction of similar legislation in Scotland, Wales and Northern Ireland earlier this year.

Under the Smoke-free (Premises and Enforcement) Regulations 2006, all enclosed or substantially enclosed public places and workplaces – including vehicles which are used for business purposes – will become 'smoke-free'.

No-smoking signs

All employers must display new no-smoking signs in their premises and in any vehicles which are used for work. 'Substantially enclosed' premises are those which have a fixed or moveable ceiling or roof and have an opening in the walls which is less than half the area of the walls (the definition of the opening does not include doors, windows or other fittings that can be opened or shut).

Smoke-free vehicles

Vehicles must be smoke-free if they are roofed and used to transport members of the public, or if they are ever used by more than one person in the course of paid or voluntary work, regardless of whether the users are in the vehicle at the same time. Such vehicles must display a no-smoking sign in each compartment which carries people and must show the international no-smoking symbol in a size no smaller than 70mm in diameter.

Exemptions

There are a limited number of exceptions to the rule, which include private dwellings, and hotels, inns, guesthouses, and members' clubs that provide sleeping accommodation, which are permitted to designate specific bedrooms for smoking. Care homes, hospices, prisons and offshore installations may also designate individual bedrooms or rooms for smoking.

Three new criminal offences will now apply, in respect of failing to: display the required no-smoking signs; failing to enforce the no-smoking rules; and smoking in a prohibited area. Infringement of the new laws will constitute a criminal offence, and those who flout the law could be subject to fixed penalties and prosecution.

Employers are advised to have in place an appropriate policy on smoking in the workplace, and to consult their employees and their legal advisers on any proposed changes to procedures.

Proposed extension to annual leave

The Government is currently considering proposals to extend the statutory paid annual leave period from 20 to 28 days.

This is in response to the fact that UK workers do not have a legal right to paid time off on public or bank holidays, and so some have to include time off for bank and public holidays as part of their statutory four weeks' holiday allowance.

Under current plans, the new right would be phased in over a period of two years, beginning with four additional days of paid leave in October 2007, and would be awarded proportionally depending on when an individual's leave starts. Any time off for bank and public holidays would be included in the additional entitlement, and the holiday would be calculated on a pro-rata basis for part-time workers.

Web *Watch* *Essential sites for business owners*

Pay Me Direct
www.paymedirect.co.uk
Tips and information for SMEs aimed at tackling late payment.

Working for Yourself
www.workingforyourself.co.uk
New HMRC website offering advice on employment status.

London 2012 Olympics
www.london2012.org
Official information for businesses on procurement and tender opportunities.

WEEE recycling network
www.weeenetwork.com
Free advice service for businesses affected by the new electronic waste regulations.

Reminders for your **Summer** *diary*

June

30 *End of CT61 quarterly period.*

Last day for UK businesses to reclaim EC VAT chargeable in 2006.

Annual adjustment for VAT partial exemption calculations (March VAT year end).

July

6 *Deadline for submission of Form 42 (transactions in shares and securities).*

Last day to file Taxed Award Scheme Returns, file P11Ds, P11D(b)s, P9Ds. Issue copies of P11Ds or P9Ds to employees.

14 *Due date for income tax for the CT61 period to 30 June 2007.*

19/20 *Quarter 1 2007/08 PAYE remittance due.*

Final date for payment of 2006/07 Class 1A NICs.

31 *Second self assessment payment on account for 2006/07.*

Annual adjustment for VAT partial exemption calculations (April VAT year end).

Liability to 2nd £100 penalty arises for 2006 Tax Return still not filed.

5% surcharge on any tax unpaid for 2005/06.

August

2 *Last day for notifying car changes in quarter to 5 July – P46 (Car).*

31 *Annual adjustment for VAT partial exemption calculations (May VAT year end).*

Deadline for tax credit Annual Declaration (if estimated, final figures required by 31 January 2008).

September

30 *Deadline for submission of the 2007 Tax Return if you wish HMRC to calculate the tax or, if you wish to have a 2006/07 balancing payment of less than £2,000 collected through your 2008/09 PAYE code.*

End of CT61 quarterly period.